

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Assembly Rev. and Tax. Analyst: Roger Lackey Bill Number: AB 1116
Related Bills: None Telephone: 845-3627 Introduced Date: 02-23-2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Deficiency Definition/Eliminate Zero NPA For Credit Carryovers/Changes In Withholding Formula/Define When Formulas Are To Be Changed

SUMMARY

This bill would:

- Eliminate credit carryover from the meaning of deficiency.
- Allow the Franchise Tax Board (FTB) the authority to issue a notice of proposed adjusted carryover amount.
- Specify the administrative rules applicable to a notice of proposed adjusted carryover.
- Specify that a law effecting a change in income tax withholding will apply to income tax withholding in the later of the calendar year the provision is operative or the calendar year succeeding the year the provision was chaptered, but in no the year such provision is chaptered.

The first two provisions will be discussed together and the third provision will be discussed separately.

PURPOSE OF THE BILL

The FTB is sponsoring this bill both to clarify that taxpayers have the right to protest and appeal adjustments to items subject to carryover and to allow FTB to adjust withholding rates the year a bill is operative, preventing unnecessary delays.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2002.

POSITION

Support.

At its December 18, 2000, meeting, the Franchise Tax Board voted to sponsor the language introduced in this bill.

Board Position:

<u> X </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> PENDING

Department Director

Date

Alan Hunter for GHG

04/02/01

ANALYSIS

Definition of Deficiency/Eliminate Zero-Tax Notice of Proposed Assessment/Add Notice of Proposed Carryover Adjustment

FEDERAL/STATE LAW

Federal and state laws define “deficiency” as the amount of tax imposed by the law that exceeds the amount of tax shown on the taxpayer’s return, less any rebates (i.e., an abatement, credit, refund, or other repayment).

As a result, under **federal law** the Internal Revenue Service (IRS) does not issue zero dollar assessments, but instead only issues assessments in the year there is a tax consequence.

However, **state law** also specifically includes within the definition of “deficiency” the amount by which a credit subject to carryover is reduced by any action of the FTB.

Existing state law provides FTB the authority to make adjustments to a taxpayer’s return. Upon adjusting a taxpayer’s return, FTB issues the taxpayer a notice of proposed deficiency assessment (NPA) illustrating the adjustments the department has proposed, including any deficiency in tax. Upon receipt of the NPA, a taxpayer has specific rights to protest FTB adjustments, and, if the taxpayer so chooses, to appeal FTB’s action of a protest to the Board of Equalization.

In addition, when FTB adjusts a taxpayer’s credit for a specific year and the subsequent adjustment of the credit carryover results in no additional tax, current law provides authority to issue a zero-balance NPA. This authority exists due to the inclusion of credit carryovers in the meaning of “deficiency.”

THIS BILL

This bill would eliminate adjustments to credit carryovers from the definition of deficiency.

This bill would allow FTB the authority to issue a taxpayer a notice of proposed adjusted carryover amount that would afford taxpayers the right to dispute the adjustment in the same manner available for NPAs.

This bill would extend the authority for proposed carryover adjustments to other items subject to carryover, such as losses and deductions.

Changes In Withholding Formula Due To Legislative Enactment/Define When Formulas Are To Be Changed

STATE LAW

Existing state law provides that any state law effecting changes in withholding will begin with the withholding for the calendar year following the year the provision was chaptered or is operative, whichever is later.

THIS BILL

This bill would specify that a law effecting a change in income tax withholding will apply to income tax withholding in the later of the calendar year the provision is operative or the calendar year succeeding the year the provision was chaptered, but in no event in the year such provision is chaptered.

IMPLEMENTATION CONSIDERATIONS

Definition of Deficiency/Eliminate Zero-Tax Notice of Proposed Assessment/Add Notice of Proposed Carryover Adjustment

Implementing this bill would improve the department's administration of the income tax laws by clarifying the taxpayer's rights and the treatment of carryover adjustments, as well as providing taxpayers with the option, but not the obligation, of protesting and appealing a proposed carryover adjustment at the time when records are more readily available.

Changes In Withholding Formula Due To Legislative Enactment/Define When Formulas Are To Be Changed

This bill also would improve FTB's ability to administer laws effectively relating to changes in withholding.

PROGRAM BACKGROUND

Definition of Deficiency/Eliminate Zero-Tax Notice of Proposed Assessment/Add Notice of Proposed Carryover Adjustment

The definition of deficiency was amended in 1982 to include a reduction of a credit carryover. Credit carryovers were added to the meaning of deficiency under the theory that it would allow taxpayers to protest and appeal potential denials of credit carryforwards for the year that the credit was earned, instead of requiring them to wait until the year the carryforward has a tax effect.

In 1982 very few credits existed, but since then multiple new tax credits have been added to the Revenue and Taxation Code. Consequently, the issue of multiple credit carryovers has resulted in the department issuing more zero-balance NPAs. California law contemplates that deficiency assessments will have a dollar amount at issue. As a result, it is unclear if a taxpayer assessed a zero balance NPA would have any rights to dispute the adjustment since there is no monetary effect.

OTHER STATES' INFORMATION

This bill would impact only California's administrative procedures.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Definition of Deficiency/Eliminate Zero-Tax Notice of Proposed Assessment/Add Notice of Proposed Carryover Adjustment

This provision would have no appreciable revenue effect.

Changes In Withholding Formula Due To Legislative Enactment/Define When Formulas Are To Be Changed

This provision could result in negative or positive cash flow acceleration, depending on the type of legislation enacted. For example, a reduction in tax rates that is operative in 2001 would result in an adjustment of the withholding tables as of January 1, 2001. Negative cash flow acceleration would occur in the last six months of fiscal year 2000-2001 due to the decrease in withholding. However, any impact would be offset due to a reduction in subsequent refunds paid out upon the filing of the years tax returns. Conversely, an increase in tax rates would result in positive cash flow acceleration for the same time period due to an increase in withholding.

The majority of tax related legislation does not include a prospective operative date but rather takes effect immediately. Therefore, this bill would have the above revenue impact only in limited circumstances.

ARGUMENTS/POLICY CONCERNS

Definition of Deficiency/Eliminate Zero-Tax Notice of Proposed Assessment/Add Notice of Proposed Carryover Adjustment

Credit carryovers should be deleted from the meaning of "deficiency" because the definition does not clearly allow taxpayers to protest and appeal reductions in carryovers as was intended. Also, the current situation has caused confusion for department staff and taxpayer representatives.

Changes In Withholding Formula Due To Legislative Enactment/Define When Formulas Are To Be Changed

Changing the law regarding withholding will ensure that legislation is properly implemented so that taxpayers do not over or underpay their tax liabilities. This bill would allow FTB to adjust withholding rates the year a bill is operative, preventing unnecessary delays.

LEGISLATIVE STAFF CONTACT

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